RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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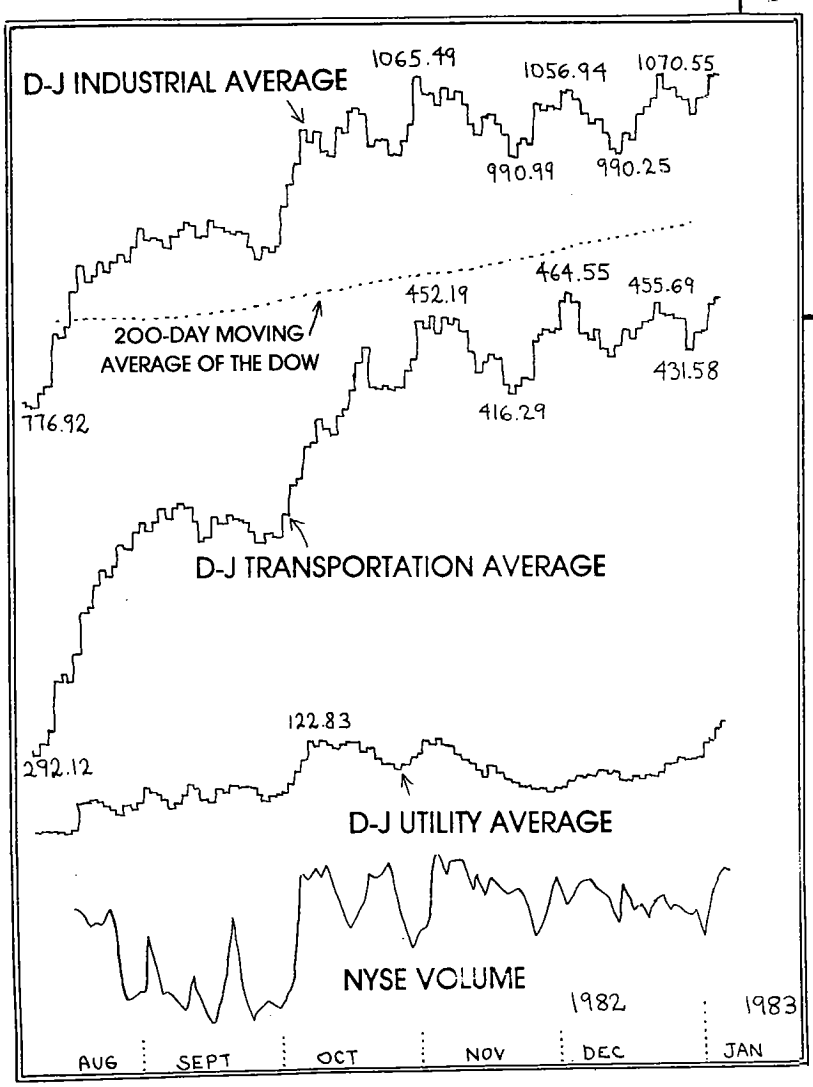
Dec. 30, DJIA 1046.54; PTI 1421; A-D Ratio –19.54
Jan. 7, DJIA 1076.07; PTI 1445; A-D Ratio –18.50

THE PICTURE: Sophistication and rapid communication have changed the face of market analysis over the past ten years. When I started writing this report in 1958 people didn't even know what the D-J Industrial Average was. Now, we follow a dozen averages and everyone is a technician, my next-door neighbor trades options and futures, and contrary opinion is almost a buzz-word. I've read scenarios for 1983 (and even for 1984 and '85) by the carload, but the distressing fact is that no one really knows what lies ahead. The consensus opinions are (1) "this is the first stage of a super three-stage bull market," and (2) "the economy in the first half of 1983 will be flat but the second half will be up." Maybe so, but I'm not sold on either prediction (I'm getting more ornery as the years go by).

What about Dow's Theory, what is it saying? My interpretation of the Averages under Dow Theory is that the trend is definitely up, but there is no denying the erratic character of the action. Since November we have witnessed a series of jockeying moves with first one Average, then the other rising to all-time highs—but at no time have those highs been registered together.



FRONT PAGE COMMENT: The finances of the US have now taken on a surrealistic look. Never in US history has an administration attempted to run the nation without a budget. But that is what has been happening during the Reagan reign. The deflationary forces of the towering US debt are now so powerful that the spector of a $200 billion deficit leaves the country still floundering in recession. Ten years ago (when the debts and deficits were considerably less) the thought of a $200 billion deficit would have sent the economy and the stock, commodity and gold markets heading for the moon!

WASHINGTON (DJ) – Peter Davis, senior tax analyst for the Senate Budget Committeee, said "internal" estimates now point to a fiscal 1984 deficit of about $220 billion.

Davis described the $220 billion projection as "sort of a composite" when asked whether he was referring to administration or congressional internal estimates.

The Senate aide served up the largest-yet fiscal 1984 deficit estimate while discussing the outlook for tax legislation in 1983 in an address to the National Economists Club.

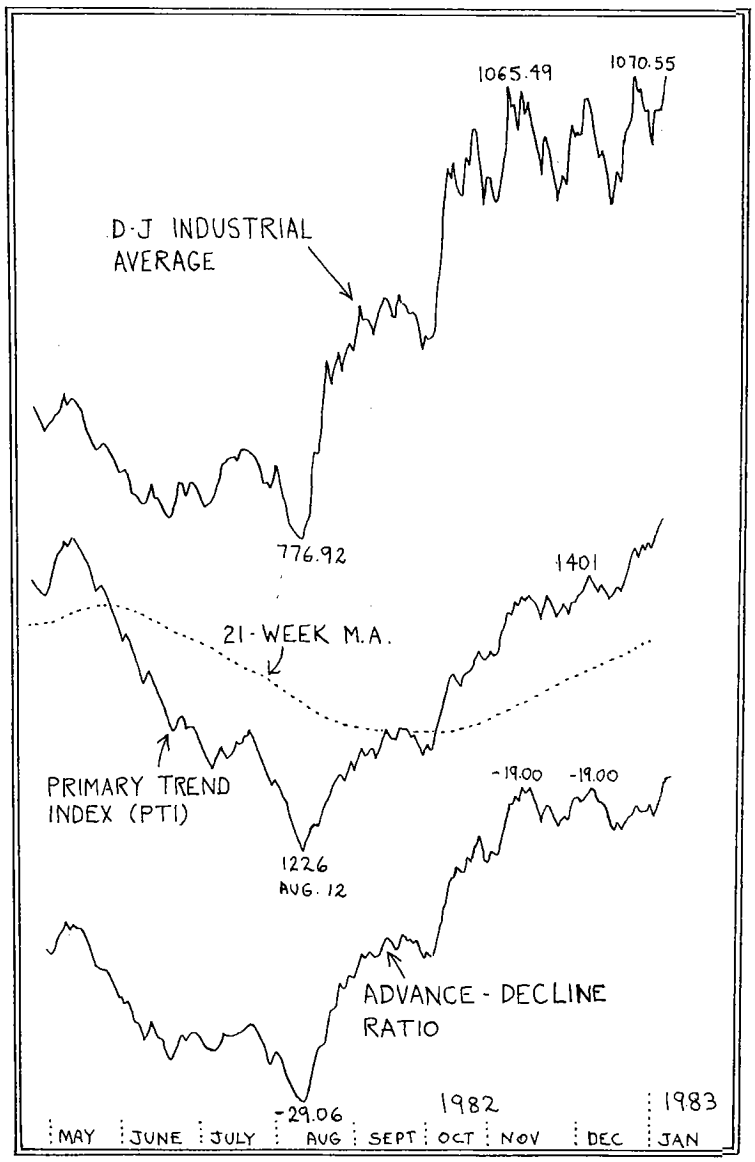
"We've got a well-over $200 billion problem," Davis said at one point with reference to the fiscal 1984 deficit.

Davis said it's virtually certain a Social Security tax increase will be passed in 1983 and predicted the House will use Social Security legislation as the vehicle for efforts to repeal the third year of President Regan's tax cut program and the indexation of individual taxes slated to start in 1985.

The most recent action saw the D-J Transports rally to a record peak of 464.55 on December 7. This high was not confirmed by Industrials. A sell-off ensued, followed by a new advance. On January 6 the Industrials rose to an all-time high of 1070.92, but here the Transports failed to confirm. Nevertheless, the benefit of the doubt must reside with the bulls. The fact is that both Transports and Industrials have risen to record highs within the last month.

Of bullish import, also, was the January 6 closing price of the Utility Average at 123.66. This was the highest closing in this Average since 1972 (and the Utilities are often a bellwether for the rest of the market).

One rather strange item is the dearth of new highs as the Industrial Average rallies repeatedly into the 1050 area. My 5-day average of new highs on the NYSE hit a peak of 457 on October 11. It touched a lower peak of 393 on November 9. On December 7 it recorded a still lower peak of 210. And on the current market advance the 5-day moving average has failed to rise even to 100.



PRIMARY TREND INDEX: What motivates a man or woman to spend thousands of hours, months, years, even decades trying to find a way to conquer the market? Some say ego, others say curiosity, still others insist that it is the challenge of the project itself. Personally, I've always felt that it was simply the urge to beat the system. If you've discovered a way to consistently milk the Wall Street cow, why you've discovered a way to sit in your living room (or your villa in Cannes) and generate money. It's a long sought after dream. "The markets are always there; if I could only discover the secret of making those markets work for ME!"

And I guess I should plead guilty to being on the same quest. Deep in my heart I've always known that there is no perfect system. I know that Wall Street is a matter of probabilities, of trying to push your percentage of good moves to say five out of ten or hopefully six out of ten. But it is a percentages game. And suppose that your first five moves are losers? Will you have the guts to make the last five trades (the ones which, statistically, should produce the winners)?

Back in the late 1960's I did a lot of thinking about the simple (yet difficult) problem of staying on the right side of the stock market. I had seen case after case of investors and advisors being confused, deceived or disastrously positioned on the WRONG side of the market (i.e., on the wrong side of the primary trend). After years of following markets, I had to face the fact that any indicator can go haywire at any given time. But the group of indicators that I found most helpful was the one that dealt with the ACTION of the market itself. If you run a group of "action-of-the-markets" indicators such as the averages, the high-lows, the A-D ratio, the bond averages, the most-active stocks, the MAJORITY of these indicators over a period of time would HAVE TO point the way to the overall trend of the market.

With this concept in mind, I spent a few years with different combinations of indicators using various formulas to arrive at what seemed the best amalgam on indices. Finally, in 1971 I came up with a composite which I called the Primary Trend Index (PTI). I've run this composite daily over a period of 12 years, and the passage of time only increases my respect for the PTI.

The rules for using the PTI are simple enough. Rule No. 1: Position yourself in harmony with the PTI. The simplest way of doing this is with a no-load mutual fund.

Rule No. 2 (this is actually a corollary of Rule No.1): It's all right to ignore the trend of the PTI but NEVER position yourself against it. Which is another way of saying, "You can skip a market move, but don't ever fight a market move." That sounds simple enough, but I've seen many traders wiped out by staying short in a bull move or long during a collapse.

Rule No. 3: The PTI tends to form reliable and extended trendlines. Use trendlines in determining the trend of the PTI, these trendlines to be confirmed by the 21-week moving average of the PTI.

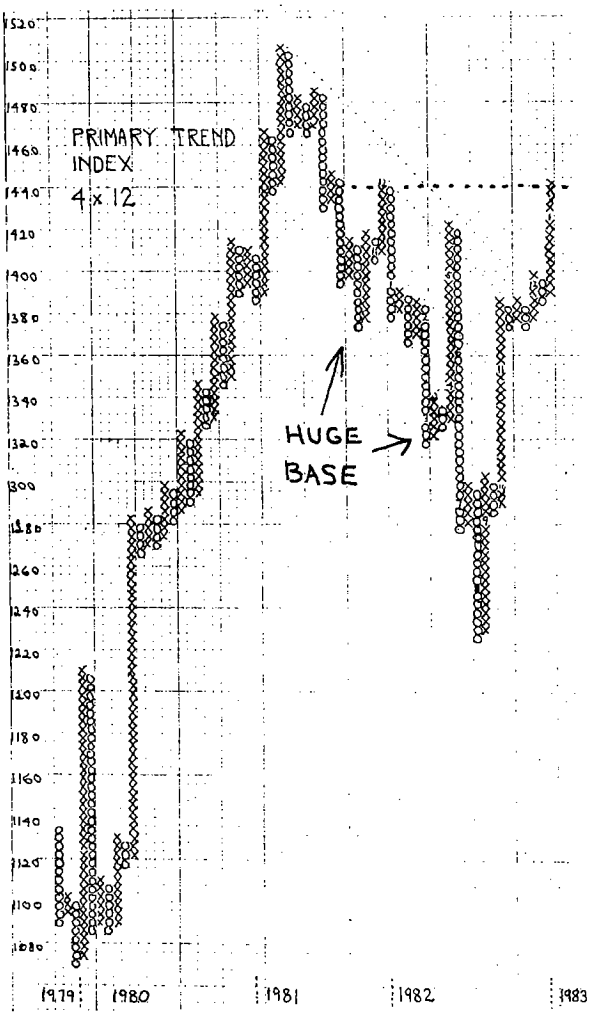
Recent market action has been, to my mind, somewhat sloppy. But the PTI seems to be ignoring all that. On January 4 the PTI closed at 1427, thereby bettering the May 11 peak of 1424 for the first time on this rise. The PTI is now better than 60 points above its 21-week moving average, and this may be stretching it a bit on the upside. Therefore, it would not surprise me to see some consolidation or more sideways movement on the part of the market. Nevertheless, the trend of the PTI is bullish, and that one single fact may be all we need to know.

I am including (page 3) my point & figure chart of the PTI, a chart taking this indicator back four years to 1979. On a cold, unemotional reading of this chart, the PTI now appears to have formed a huge bottom. Frankly, in a dozen years of tracking the PTI I've never seen anything like a bottom of this size in the PTI. Last week the PTI bettered its May, 1981 high at the 1424 box. The next objective is the 1444 box of December, 1981. If the PTI can rally above the 1444 box its next target will be the 1508 box of June 23, 1981 (this was the all-time high on the PTI).

In my technical analysis of the PTI, I don't attempt to explain the "why's" and "How comes" of this indicator. I do analyze WHAT IT IS DOING. With the formation that has now appeared on the point & figure chart of the PTI, it is clear that a massive bullish potential exists for the stock market. By any reckoning, it appears that a massive base has now formed in the PTI, a base large enough to take the PTI far above its old high.

Question: Russell, never mind your so-called cold technical approach. Tell me what you think is happening.

Answer: All right, look at it this way. The Fed is pumping its head off, and this action will probably show up in inflationary



statistics six months to a year from now. On top of that it is clear that the Fed is willing to give away everything including the White House and the Washington monument in order to keep the major banks afloat. Meanwhile, business is not doing anything very exciting, but it's not falling apart either. Actually, business is starting to creep up.

Real estate made its move during the 1950s to 1970s, and it's quiet now. Business is slow, and little money is going into capital expenditures. The public is scared stiff and trying to save a bit (while paying off its bills). And the bond market has already made its move on the upside.

So what's left? That's right, stocks. Stocks are the only game in town, and that's where the action is. Even the gold shares (which are stocks) are (or have) exploded, and this occurred while gold failed to go over its previous high. Thus, gold bullion is acting more like the sluggish commodities while gold shares have been acting like stocks. It seems to me that the PTI has said it all. The base has been laid for a major move in stocks (while perhaps business, commodities, housing, etc., will pick up later in the year). And all of this has the almost hysterical blessing of Mr. Reagan, the administration and the Fed.

Question: So you're bullish on the whole picture, Russell?

Answer: Not entirely. I don't like what I see happening in this country, as anyone who has read these reports for even a few months knows. I think this nation is running on a course that can only lead to bankruptcy. But I'm a market analyst, not a political philosopher or historian. Put it this way–from what I see I'm bullish on stocks and bearish on the US. The way things are going, we're heading for some kind of moratorium on debt and a long-term slide in our standard of living. But the stock market (which can change its mind in a day) says that so far, it's all going to hold together and, in fact, even get better. It's a strange picture, and I'm tempted to repeat the words of the American Novelist, James Farrell: "Alone and afraid, in a world I never made."

INVESTMENT POSITION: Many subscribers ask me, "Which no-load funds should I buy?" I follow three services that monitor the no-loads, and I suggest that readers subscribe to one of these useful services. They are, United Mutual Fund Selector, 210 Newbury St., Boston, Mass. 02116. No-Load Fund X, 235 Montgomery St., San Francisco, CA 94104. Growth Fund Guide, Yreka, CA 96097.

In answer to requests for addresses of gold funds, the United Services Gold Fund is at PO Box 29467, San Antonio, TX 78229 and the Fidelity Precious Metals Fund is at 82 Devonshire St., Boston, Mass. 02109. Either of these no-load funds can be used for gold share participation. Gold shares (recommended repeatedly here) have continued to be the most profitable area of the markets, and I still like them.

With the PTI now strongly bullish, a portion of our money can be invested in no-load funds. Gold shares have roughly doubled, and I would certainly hold what you have in the gold shares for now.

Based on the huge base in the PTI, I am placing the bull back in this box. I feel a bit squeamish about this, but I won't fight the PTI–it knows a lot more about what's going on than I do.

Following are a few no-load funds that I favor: Columbia Growth Fund, 800/547-1037; Fidelity Magellan Fund, 800/225-6190; Janus Fund, 800/525-3713; Nicholas Fund, 414/272-6133; 20th Century Select Investors, 816/531-5575.

IT'S NEVER EASY: In the last Letter I included a piece entitled "I've Learned", and in it I listed a number of market observations that have struck me over the years. I received a large number of letters about this piece with many of the correspondents offering rules of their own.

One of the observations that particularly interest people was the one that states that "there are no geniuses on Wall Street." Over the years I have followed a great many case histories, and I can say that I know of almost no instance where one man has become rich following the advice of another man. I have seen streaks of good fortune, I have seen a run of two or even three good years, but I have never seen an instance where someone has come up to me and said, "Russell, I followed the Gizmo Service for five years and I have made a fortune. Believe me, I thank my lucky stars for the day I decided to follow Mr. Gizmo."

Why is this? Why can't you subscribe to this or that service and run their portfolio suggestions into a multi-million dollar fortune? The answer is simple: few if any services are that good! I've seen many advisories that have been right on a move, even right on a major and profitable move. But advisories that are right over a five or ten year period? You find 'em, I've never been able to.

To illustrate the above, I could come up with any number of fascinating case histories. But I am going to pick two analysts who are not now living (I do this to avoid embarrassing some of my living friends). Robert Rhea (a pioneer Dow Theorist) was probably the greatest reader of the averages of all times. Rhea correctly called the 1932 market bottom (it was an absolutely unhedged call), and he called it to the exact week. Rhea was correctly bullish all the way up to the 1937 bull market top. Rhea next called the 1937 bear market perfectly (by this time he was famous). Then in 1938 and 1939 during that difficult and whip-sawing market Rhea became confused. His writing turned tentative, filled with frustration. Robert Rhea died later in 1939, and I have always felt that the difficulty of the 1938-39 period contributed to this remarkable man's death.

Another example that comes to mind is my brilliant friend, E. George Schaefer. George started his service in 1948. He called the great 1949 market bottom on the button, then rode the entire bull market to 1966, rode it up in a fully invested position. Schaefer's two model stock portfolios rose from fifty thousand dollars each into the millions. And those who followed Schaefer (I never met anyone who followed him ALL the way) did mighty well. But then in 1974 Schaefer got in trouble with his beloved gold. He missed the gold collapse of that year, got confused or depressed, and committed suicide. Schaefer's death was a great shock to me. I have always been of the opinion that George's own ego, his reason for existence, somehow got mixed up or intertwined with his opinions on the market.

So I've learned that no one should follow any advisory with slavish devotion. I personally have tracked certain advisory services for years (two for over twenty years), and I've learned to take what is offered but always with a critical eye. I've never followed an advisory service that didn't go totally off the track at one time or another. It just happens. The markets are structured that way–and so are human beings.

My smartest and most successful subscribers seem to ask least of me and my efforts. I have people or institutions or corporations who have been on the subscription list for years who have never corresponded with me, never complained, never complimented me and never questioned my conclusions. They take what they want from the Letters and I never hear from them. When a subscriber calls or writes every week I know in my heart that he will not stay with me. I know because such subscribers are asking more than I can give, and they are depending too much on me. Successful investors place the ultimate judgments and decisions in their own hands. To do less is to court disaster. I've seen it happen over and over again.

So the lesson I'm trying to get across is–do your own work. Continue to think, to read, to learn, to wrestle with the markets and your investments. The professionals don't have to read this–they KNOW it. If the pro's beat their brains out 10 to 14 hours a day trying to run their money correctly, don't think you can do it simply by reading your local paper or by following your neighbor's latest hot tips.

As far as Dow Theory Letters is concerned or as far as any service is concerned, read us with an open mind but a skeptical mind. I have many readers who subscribe only for the PTI. I have others who are only interested in my gold opinion. Still others are concerned with my views on the economy or on debt. Nobody I know swallows everything I have to say. If they did, they'd be making a mistake. Neither I nor anyone else have even 10% of the answers regarding investments or the economy. Interestingly, most sophisticated investors tend to subscribe to a number of advisory services. They do so on the following premises: (1) "I got hooked on this service, and I am still curious to see what this guy is saying." (2) "If this service comes up with one or two good ideas a year it is worth the money." (3) "I heard that this service is pretty good, and I want to follow it for a while." (4) "This service provides me with certain data that I need for my work–and that's the only reason I subscribe." (5) "I read everything I can get my hands on, and this is merely a part of my weekly inflow."

So that's my story for this Letter. Remember, there are a few geniuses on Wall Street, but (unfortunately) there are no geniuses who are right all the time.

NOTES & QUOTES: Recent articles in the WSJ and elsewhere note that Atlantic City and Las Vegas are having a hard time. The "high rollers" are becoming scarce, and many casinos are turning increasingly to the "grind." The grind is gambling talk for grinding the money out of the low spenders via the slot machines and low-anti card games. Of course, it occurred to me that many gambling types really don't have to go to Atlantic City or Vegas any longer. They can stay right in their home towns and play the option markets or the commodity futures markets. The truth is that Wall Street now has more gambling devices than Vegas has, and the Street comes up with another new concept every week or so.

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The following letter from a subscriber interested me considerably, and therefore I thought it might interest my readers. Here it is, thanks to J.E.H.

"Regarding your discussion of 'accumulators' on Page 5 of Letter 850, I recently read an interesting book entitled "Getting Rich Your Own Way" by a psychologist (forgot her name). Her book covered a study she did of 1000 individuals she picked at random in their early twenties whose careers she followed for two decades. She wanted to see who would become millionaires and how they did it. Her results were astounding. Out of the 1000, 84 became millionaires during the study period, although some of these made a million and lost it, some several times.

"Out of the 84, NONE OF THEM SET OUT TO MAKE MONEY. While many of the original group specifically set out to make a million, usually by playing the stock market or some other get rich quick investment, none of them even got close! The one common characteristic of those who did become millionaires was that they did professionally what they enjoyed doing, they became very good at it, and made their money incidentally. There were many "traders" in her study, but they were not in the millionaire class.

"Another key feature of those who made and kept their millions was that they were "low rollers", i.e., they *accumulated* wealth and didn't take risks. They made their money from what they did, not from investing. The only place where investing played a big part was *after* they made their first million or two, at which point the size of the capital demanded more attention and many of them turned to investing as a major activity. Only then were they successful in parlaying their fortune into a bigger fortune through that route.

"This book supports your thesis and perhaps if you get a chance you might want to look it up."

And here's a second letter from MLB, NYC. I seldom publish a letter in these reports, but when I think a letter is particularly informative, I do include it. And I'll admit it–I love letters from people in their 70s, 80s and beyond. When you've been around for 70 or 80 years you've accumulated a vast reservoir of experience to guide you. We youngsters can learn from the real old-timers. (In case you're wondering, R. Russell is 58 years old).

"This letter neither requires nor expects a reply–so relax.

"I originally subscribed because I wanted to know more about the Dow Theory. Thank you, I have learned.

"Because I have been in the business nearly twice as long as you (45 years), and have an excellent historical background, I have not necessarily followed your investment advice–which I think excellent for people who do not have the courage of their convictions.

"In Letter 850, you finally say in so many words, that a good case can be made for either a bull or bear market–exactly what I have been thinking. Because I was unable to decide, I began accumulating Krugerrands and gold stocks in 1973. The profits in Anglo-American gold were so huge and the dividends so variable, that I took those profits and put the loot into AAA Corporates late in 1981. The yield on that money now is 5 times what it costs me to live. Then I added US Treasury's 2096-01 in the low 60s. My gold stocks that I had had (some before 1973) are ASA, Dome Mine, Homestake and Newmont. With some spare cash this fall, I added Campbell Red Lake.

"You say an investor is an accumulator. I have been accumulating stocks since 1935 when I bought 5 shares of Atlantic Refining. Every time I had a few hundred dollars saved up, they went into small amounts of oils, chemicals, electronics, drugs, photographic stocks. You are absolutely right in saying that is the way to be comfortably well off. My aim was to accumulate such things as I thought would last, and so would take care of me when old. I will be 81 in a few weeks, and have no financial worries.

"An uncle talked finance at me for six years before he told me to go ahead. The best rules he gave me to go by were (1) buy low and sell high, and (2) listen to what everyone says, then do your own investigation, but *never* buy or sell *because* someone else tells you to–*make your own decisions.* He did not leave me much cash, but he left me a fortune in those lessons.

"Your Letter strikes me as the most reasonable and best balanced of any of those I have tried (8 in all)."

WHITHER REAGAN? What has happened to Reaganomics? Oh, that's easy, the President gave up on it months ago. I wrote way back before the election that Reagan had to tell the American people the real story of what was happening. I said then that Reagan should tell the American people that we were going to cut spending, end inflation, stop deficit spending and survive the inevitable hard times that would follow from such "cold turkey" treatment. He should have run on that ticket, and, if elected, Reagan would have had a mandate to "do it" once and for all.

But Reagan chose to tell the people that he was going to cut taxes, build up the military and simultaneously cure inflation. That was tantamount to saying that he was going to stand up and lie down–at the same time. It was ridiculous–and it didn't work.

The liberals, the taxers and the spenders have never liked Reagan; they were never for him or behind him. But Reagan did have a coalition of conservatives in both parties, the neo-conservatives and even a few liberals who were sick of what was going on. "If not now, when?" Reagan asked, "If not we, who?" In the short time since the Reagan inauguration, almost all the concepts of the original Reaganomics have come apart or been jettisoned. The original concept of balancing the budget in 1984 has become a nightmare, the lowering taxes concept has become a joke, and (as usual) the cry is for more domestic spending and more "fairness" in taxing (a euphemism for higher taxes).

The *Wall Street Journal's* editorials represent, I feel, the most intelligent and the fairest of the conservative writings. Yet if one reads the Journal editorials one can see the disillusionment (even the bitterness) which has crept in. The following is from a November 5 editorial in the Journal.

> **It is a canard to suggest that Mr. Reagan has been uncompromising; he stretched out his tax cut into almost nothing, backed away from proposals for Social Security reform and raised taxes last year. On the fiscal front, he has managed to stabilize taxes these last two years despite bracket creep and Social Security tax boosts, to legislate the real tax cut scheduled for next year and to bend the growth path of spending toward a somewhat smaller increase. On the monetary front, he has been spasmodically supportive of Mr. Volcker's anti-inflation fight. Any more compromise and there would have been no policy.**

And this is from the November 30 Journal.

> **The president started out as a tax cutter but now seems to be inclined to tax anything that isn't nailed down. He has just signed onto a gasoline tax that Howard Baker and Tip O'Neill came up with as a way of being able to say they were creating a "jobs" program through increased highway funding.**

OWING BUCKS: On December 30 Brazil announced that it was suspending payment of principle on its monster debts. Over the foreseeable future, Brazil will attempt to pay only the interest on its debts (the interest in large part would be paid by new loans from the IMF and the banks). Thus, Brazil now joins Mexico and Argentina in what will probably go down as the greatest Ponzi scheme (moratorium, if you wish to be polite) in financial history. The total debt owed by the South Americans and undeveloped nations is about $750 billion. The bulk of this debt will ultimately have to be written off as uncollectible.

The game now is to avoid putting the label "no good" on these loans. If that happens, most of the major US banks would sustain such huge losses that they would be insolvent. It's a massive deception, but it's one the Western world wants to play. Personally, I am for facing the truth. The banks made disastrous loans. Those loans cannot be held up by lies. In the end some-

one has to pay for bankruptcy. Better the banks and their shareholders than the citizens of the United States via deceit and monetary inflation (issuing additional credits through the IMF or anyone else is a way of inflating the US currency).

A Brazilian banker was quoted as saying, "I owe the bank ten thousand dollars, I'm in trouble. I owe the bank ten million dollars, they're in trouble." And I've been wondering, if you owe the banks ten billion dollars, who is in trouble. The answer is now clear. It's the citizens of the US who are in trouble. Why? Because when the US Government gives away billions of dollars, those billions can only come from one of two sources–taxes or inflation via newly printed dollars.

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BWG of Church Falls, Va. has a legitimate complaint. He writes, "One remark you make is not valid, you say 'be patient–don't get excited, the market is always there'.

"The market will be there, yes–but I won't always be there. Think about that a little in relation to the varying ages of your subscribers."

Thanks, and I will.

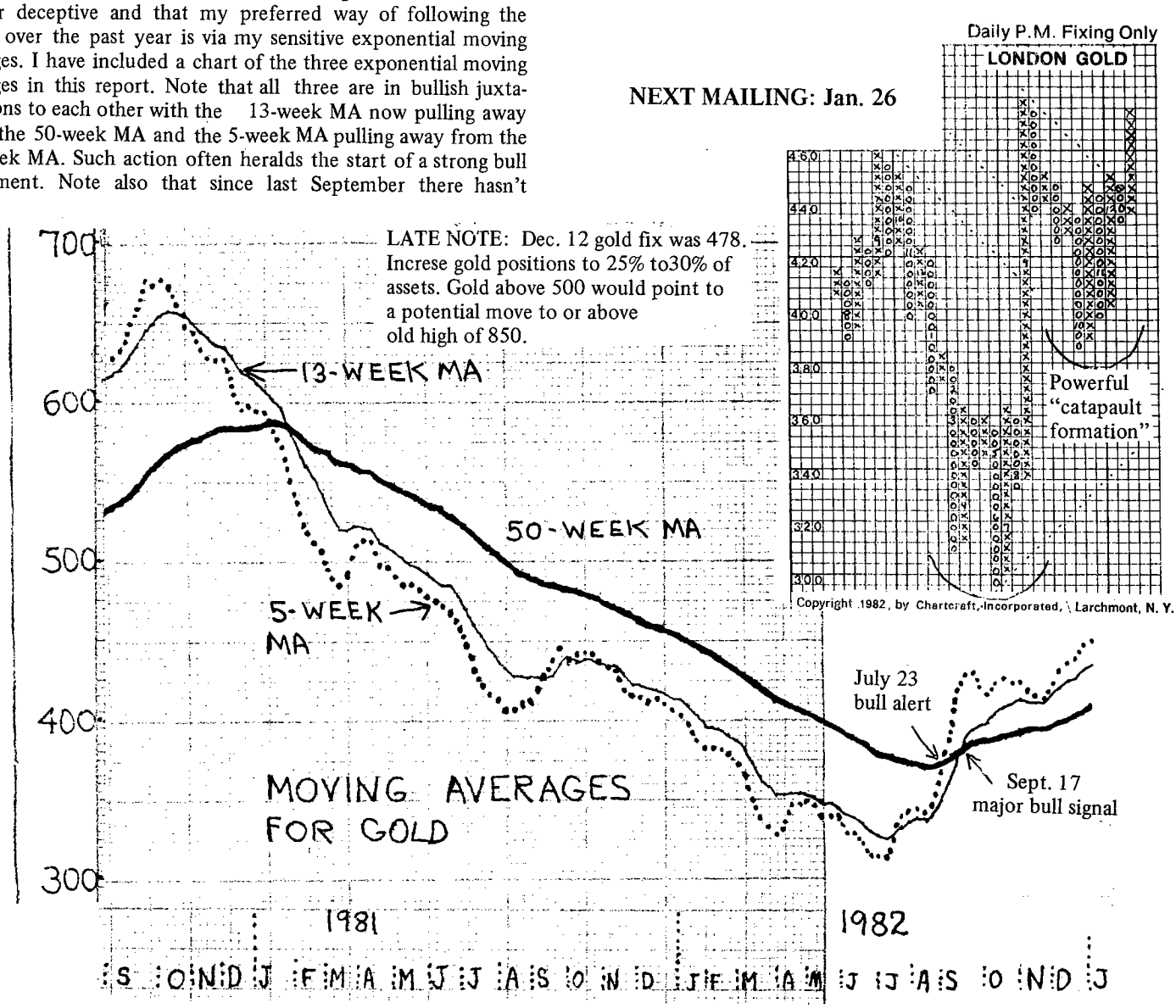
GOLD: I've stated repeatedly that the gold action has been rather deceptive and that my preferred way of following the metal over the past year is via my sensitive exponential moving averages. I have included a chart of the three exponential moving averages in this report. Note that all three are in bullish juxtapositions to each other with the 13-week MA now pulling away from the 50-week MA and the 5-week MA pulling away from the 13-week MA. Such action often heralds the start of a strong bull movement. Note also that since last September there hasn't been a bad moment for the bulls–as far as the moving average study is concerned.

The second London fix for gold on January 7 was 465, and this provided a bullish signal for the metal (see P&F chart). The next target for gold is the 480 peak of September. If gold can better 480, it will be a very bullish event, and I would then expect to see bullion rally into the 500s.

Everybody asks, why are the gold shares outperforming the bullion? And my answer is that you're dealing with two kinds of buyers. The person who buys the gold shares tends to be more of a speculator. He's not putting away the share certificates on a survival basis–he's looking to make profits in gold stocks. On the other hand, the person who buys 50 Maple Leafs is a survivalist. He's putting away those gold pieces for his kids, and he's not interested in whether gold goes up $4 today or tomorrow or next week. He's putting away real money for the long term.

Nevertheless, as the moving averages show, the bullion is moving up, and in the world of markets, nothing moves up "slowly" for too long. Ultimately, the speculators pounce on a rising item and give it a "zutz" (that's a word I just coined–gold coined, that is!).

NEXT MAILING: Jan. 26


LATE NOTE: Dec. 12 gold fix was 478. Increse gold positions to 25% to30% of assets. Gold above 500 would point to a potential move to or above old high of 850.
13-WEEK MA
50-WEEK MA
5-WEEK MA
MOVING AVERAGES FOR GOLD
July 23 bull alert
Sept. 17 major bull signal
700
600
500
400
300
1981
1982
S O N D J F M A M J J A S O N D J F M A M J J A S O N D J
Daily P.M. Fixing Only
LONDON GOLD
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